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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

PROCUREMENT AND SYSTEMS
ACQUISITION DIVISION

JUL 6 1972

B-159344

The Honorable
The Secretary of Defense



NO
Attention: Assistant Secretary of Defense
(Comptroller)

Dear Mr. Secretary:

We reviewed selected costs incurred by the McDonnell
2 Aircraft Company, St. Louis, Missouri, under the cost-plus-^{0,183}
3 incentive-fee phase of an Air Force contract for the design, ²
development, and manufacture of the F-15 aircraft.

McDonnell has awarded six subcontracts since July 1968
for the prolonged services of a significant number of engi-
neers. Subcontracting for these engineering services in-
creased the cost of the F-15 contract. In addition, other
Defense and National Aeronautics and Space Administration
(NASA) contracts may have been similarly affected.

Two of the subcontracts, valued at \$1.4 million, provided
engineers to work on the F-15 program during the periods May 4
1970, through May 3, 1971, and October 7, 1970, through Sep-
tember 30, 1971. On the basis of information furnished to us
by McDonnell, we estimated that McDonnell's costs under these
two subcontracts through June 1971 were about \$286,000 higher
than they would have been if McDonnell had directly hired
engineers having comparable skills.

NEED FOR SUBCONTRACTING

Under the terms of the contract, the prime contractor was
not required to obtain, nor did it request, the Government's
approval before awarding subcontracts for engineering services
The Naval Plant Representative Office (NAVPRO), responsible
for contract surveillance at McDonnell prior to 1971, however,
did comment on one of the subcontracts. In a memo to the
McDonnell buyer, NAVPRO stated that this type of contract
should be discouraged; that there was no evidence of the ex-
tent to which the contractor had tried to recruit engineers;

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that the potential to hire engineers should be fruitful because so many airframe contractors were in distress; and that, if the proposed subcontractor did not subcontract these engineers, the subcontractor may lay off engineers that McDonnell could then hire.

R At McDonnell's request, the Defense Contract Audit Agency (DCAA) reviewed the rates proposed under one subcontract. In its audit report to McDonnell, DCAA stated that the contractor should hire the engineers required rather than subcontract them and thus save the Government approximately 33 percent of the proposed cost. ^{0.1831}

Apparently disregarding the comments by NAVPRO and DCAA, McDonnell awarded the subcontracts for engineering services. DCAA, although recognizing that the subcontracts would cost the Government considerably more than the direct hiring of the engineers, has given interim approval to McDonnell's claims for reimbursement of F-15 contract costs, including costs incurred under these subcontracts.

Prolonged subcontracting for engineers

One of the two subcontractors which furnished engineers for the F-15 contract has supplied engineers to McDonnell since 1962. While supplying 50 engineers under the F-15 aircraft subcontract, it was supplying about 90 under a NASA program subcontract. Twenty of these engineers worked at McDonnell an average of 13.2 months. Only 31 of the 50 engineers were employed by the subcontractor immediately prior to the F-15 subcontract, and only 23 were retained after its completion. McDonnell hired one of the engineers for its staff. A subcontractor official said that the number of engineers in one of its divisions had been reduced from about 5,000 in 1969 to about 500 in June 1971.

Employer functions by McDonnell

For all practical purposes, the subcontracted engineers could have been considered employees of McDonnell, because McDonnell:

- Selected engineers to work at its plant.
- Provided technical direction and supervision.
- Furnished the engineers with all needed facilities, equipment, and supplies.
- Maintained time records for each engineer.
- Determined when to release each engineer from its plant.

ALLOWABILITY OF EXCESS COST
RESULTING FROM SUBCONTRACTING

The Armed Services Procurement Regulation (ASPR) provides that reasonableness be considered in determining the allowability of individual items of cost. ASPR further states that, to determine whether a given cost is reasonable, one should consider whether the cost is generally recognized as ordinary and necessary to conduct the contractor's business or to perform the contract and whether a prudent businessman would take similar action in the circumstances, considering his responsibilities to the owners of the business, his employees, his customers, the Government, and the public at large.

CONTRACTOR COMMENTS

McDonnell officials questioned whether, in our computation of excess cost, we deducted the costs saved by subcontracting--such as the costs for recruiting and processing applicants for permanent employment and the special costs of dismissing employees after short-term employment. We acknowledged that such costs had not been considered because we believed them to be insignificant. It appeared that (1) McDonnell's existing personnel staff could have handled the additional hiring, (2) the required number of engineers was small in relation to total employment, (3) a substantial number of local engineers apparently were unemployed, and (4) the engineers would have been employed for a considerable

B-159344

length of time. Further, our computation did not include the cost of awarding and administering the subcontracts. Although we requested it, McDonnell did not furnish us with any specific information to support the position that substantial costs may have been incurred as a result of hiring the engineers.

McDonnell officials also stated that only a portion of any additional costs would have been charged to the cost-plus-incentive-fee F-15 contract because of the cost-allocation methods used. Using a method suggested by these officials, however, we determined that about \$212,000 of the additional costs had been charged to this contract. Also, since more than 95 percent of McDonnell's total business costs were allocated to Government contracts in 1969 and 1970, most of the additional costs were charged to such contracts.

AGENCY COMMENTS

An official of the Air Force Plant Representative Office, which is now responsible for contract surveillance at McDonnell, said that these engineering-service subcontracts did not require the contracting officer's consent. He said also that a detailed study would be necessary to determine whether or not it was essential that McDonnell subcontract for engineering services.

PRIOR REPORTING OF SIMILAR SUBCONTRACTING BY MCDONNELL

We previously reported on McDonnell's practice of subcontracting for engineering services to the Secretary of Defense on June 14, 1966 (B-159344). In response to this report, the Navy stated that, in accordance with Department of Defense Procurement Circular 10 dated July 23, 1964, it had required, and would continue to require, its contracting officials to critically review and evaluate the need for contractors to subcontract for personal services. Our current review, however, indicates that substantially the same situation exists.

We shall appreciate hearing your views on whether you feel unnecessary costs are being incurred by McDonnell for engineering services and, if so, what action should be taken to avoid this. If you desire any additional information we may have on this review, we shall be pleased to furnish it.

Copies of this letter are being sent to the Director, Office of Management and Budget; the Administrator, National Aeronautics and Space Administration; and the Secretary of the Air Force.

Sincerely yours,

A handwritten signature in dark ink, appearing to read "R. W. Johnson". The signature is written in a cursive style with some loops and flourishes.

Director, Procurement and
Systems Acquisition
Division